STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Great Northern Utilities, Inc	)	
Proposed General Increase in Water Rates	)	ICC Docket No. 11-0059
	)	
Camelot Utilities, Inc.	)	
Proposed General Increase in Water and	)	ICC Docket No. 11-0141
Sewer rates	)	
	)	
Lake Holiday Utilities Corporation	)	
Proposed General Increase in Water Rates	)	ICC Docket No. 11-0142
	)	Consolidated

The People of the State of Illinois's Application for Rehearing

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Table of Contents

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Great Northern Utilities, Inc Proposed General Increase in Water Rates	)))	ICC Docket No. 11-0059
Camelot Utilities, Inc. Proposed General Increase in Water and Sewer rates	))))	ICC Docket No. 11-0141
Lake Holiday Utilities Corporation Proposed General Increase in Water Rates	))))	ICC Docket No. 11-0142 Consolidated

The People of the State of Illinois's Application for Rehearing

The People of the State of Illinois, by Attorney General Lisa Madigan ("People" or "AG"), request that the Illinois Commerce Commission ("Commission") reconsider and grant rehearing of its Final Order in this docket, entered and served on November 8, 2011, pursuant to Section 10-113 of the Public Utilities Act, 220 ILCS 5/10-113 and 83 Ill. Admin. Code 200.880. In this docket the Commission approved extraordinarily large increases in water and/or sewer rates and revenues as follows:

Great Northern Water:	251.72% increase in water revenues
Camelot - Water:	212.61% increases in water revenues
Camelot - Sewer:	88.20% increase in sewer revenues
Lake Holiday Water:	48.00% increase in water revenues

Final Order, App. A, B, C, D. All four operating companies will be referred to jointly as "Companies".

As more fully set forth below, the Commission should reconsider and rehear the following issues:

Issue 1. The Commission Should Reopen the Record to Reduce or Moderate The Rate Increases Allowed In The Final Order To Prevent Rate Shock.

Issue 2. The Commission's Final Order Should Reduce the Companies' Return on Equity Due to Poor Management.

Issue 3. The Commission's Final Order Should Be Amended to Reduce the Size of the Rate Base For Each Company To Eliminate Unexplained Expenditures.

Issue 4. The Commission's Final Order Should Eliminate the Allocation Factor Adjustment Because the Adjustment Lacks Sufficient Evidentiary Support.

Issue 5. The Commission Should Reopen The Record To Take New And Additional Evidence About A Possible Sale Of Utilities Inc. By Its Parent Company Highstar Capital.

The Commission's Order in regard to these issues is not supported by substantial evidence produced by the Companies, the Staff of the ICC, and Intervenors, is legally insufficient under Illinois law, and lacks sufficient analysis to allow informed judicial review. See 220 ILCS 5/10-201(e)(iv). In regard to Issue 5, the People request that the Commission open the record to consider new evidence.

In support of this application for rehearing the People submit the following:

For each of the following issues, the People incorporate by reference all previously briefed arguments, including the arguments in the People's Initial Brief, Reply Brief, Exceptions and Brief on Exceptions and Reply Brief on Exceptions and the arguments in the Initial and Reply Briefs of the Camelot Homeowners Association and the Exceptions and Brief on Exceptions and Reply Brief on Exceptions of the Camelot Homeowners Association. For all the reasons stated in those briefs and for the additional reasons set out in this Application, the People seek rehearing.

A. The Rate Increases Allowed In The Final Order Are Not Just and Reasonable and Should Be Reduced or Moderated to Avoid Rate Shock.

The Order granted a rate increase to the Companies while acknowledging that the increases are very high. In so doing, the Commission erroneously stated that there is "no legal basis for the Commission to reject a rate increase that reflects the reasonable cost of providing

utility service and instead direct the Companies to refile a rate increase request". Order at 33. This conclusion begs the question of when a rate is "reasonable." In addition to challenging the size of the increase based upon reductions in rate base, expenses and ROE recommended by the People, the Commission has the authority and the duty to determine whether utility management has fairly and reasonably managed its operations and revenue so that consumers are not subject to monopoly pricing. The principle of rate shock is an established doctrine that recognizes that extraordinarily sudden and high rate increase requests demonstrate management failure. Such rate increase requests can be rejected as unreasonable and unjust and in violation of the cardinal principle of gradualism.

As demonstrated in the People's briefs and discussed below, the record does not support granting the Companies the full amount requested even in the absence of a rate shock adjustment. All of the Staff witnesses and AG witness Roger Colton recognized that increases ranging from 48% to more than 250% represent rate shock, and the record demonstrates that the requested rates for the Camelot and Great Northern Districts would result in rates that are among the highest water rates in the state – irrespective of whether the operating utilities are publicly or privately owned. AG Ex. 1.0 at 9-10, *App. B (Carbondale survey), App. C and D (ICC water and sewer survey).

The Commission expressed concern about the increases (they "are not small and economic conditions are difficult,") and expressed "frustration" at the Companies' decision to forego rate adjustments to the point that consumers now face triple digit increases, to be imposed virtually overnight. Order at 33-34. As the Order noted, had the Companies used the Commission's simplified rate procedures for small companies, "rate increases would have

occurred in more gradual increments and the costs for those cases would have been less expensive." *Id*.

While approving substantially all of the increases requested, the Commission directed the Companies to refile their rate increase request. Order at 33. The People request rehearing so that the Commission can reconsider the Companies' rate increase request and consider options to moderate the effect of rate increases on consumers. The People ask that consistent with the principles of gradualism and avoidance of rate shock, the Commission direct the Companies to propose a way to moderate the size and pace of rate increase to protect consumers.

The language of the Order gives the impression that the Commission does not have the authority to limit or moderate large rate increases such as those requested in this docket. Order at 33. This restrictive reading of the Commission's authority is not justified by the law, and constitutes legal error. Early United States Supreme Court cases on utility regulation demonstrate that regulatory commissions can set rates within a range of reasonableness, and that they are not limited to a particular result. For example, in *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 109 S. Ct. 609 (1989), the Supreme Court affirmed a Public Service Commission decision despite the refusal to include recovery of certain cancelled plant. The Court said:

> We also acknowledged in that case [*Hope Natural Gas*] that all of the subsidiary aspects of valuation for rate-making purposes could not properly be characterized as having a constitutional dimension, despite the fact that they might affect property rights to some degree. Today we reaffirm these teachings of *Hope Natural Gas*: '[I]t is not theory by the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unreasonable, judicial inquiry …is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.' [320 U.S.] at 602, 64 S.Ct., at 288.

488 U.S. at 310, 109 S.Ct. at 617. The Commission is entitled to review all aspects of a utility's operations to assure that the public is protected from unreasonable practices. 220 ILCS 5/9-201.

The Commission can act within a "zone of reasonableness" and is only limited by constitutional constraints "at the margins." *Permian Basin Area Rate Cases,* 390 U.S. 747, 88 S. Ct. 1344 (1968); *Duquesne*, 488 U.S. at 310, 109 S.Ct. at 617.

A regulatory commission's power to adopt a rate moderation or a rate "moratorium" plan was expressly approved in *Permian Basin Area Rate Cases, supra*. In that case, the Court said that "administrative authorities must be permitted, consistently with the obligations of due process, to adapt their rules and policies to the demands of changing circumstances." 390 U.S. at 784, 88 S.Ct. 1369. The Court approved a Federal Power Commission's order that limited charges to a specified maximum, notwithstanding existing contracts with escalation clauses that could result in higher charges.

In the instant case, the Commission erred as a matter of law in finding that its authority is limited to increasing rates to the full amount to cover all costs identified by the Company and to produce a rate of return that was calculated without regard to management failures or principles of gradualism. The People request that the Commission order rehearing and reopen this docket to reduce the rate increase requested to reflect management failures, to moderate the rate impact consistent with the principles of gradualism, and to order the Companies to offer a rate moderation plan.

Other states have adopted rate moderation plans for the Companies' affiliates. See Order Approving Settlement Agreement, TN PSC, Docket 09-00017 (Sept. 15, 2009); Order, Maryland PSC, No. 9248 (June 2, 2011). An order for rehearing will provide the necessary proceeding to consider rate moderation for these large increase requests. The rate increase request should be reheard and the proposed rate increases that are unexplained and unjustified should be denied in order to avoid rate shock.

The increases allowed by the Commission also violate consumers' legal right to rely on the regulatory promise made by a utility company to only charge just and reasonable rates and to adjust those rates gradually, and as needed to cover their costs. Rates that have been approved by the Commission are conclusively presumed to be reasonable until they are modified in a subsequent rate order. AG Ex. 1.0 at 14. The law and regulatory principles are based on the premise that consumers can expect that they will not be blindsided by doubled or tripled utility rates all of the sudden. In *Commonwealth Edison Co. v. Illinois Commerce Commission,* the Court discussed promissory estoppel in the context of a utility company's change to rates. There, business customers complained that the utility should be prevented from removing an incentive program because "after decades of buildings being constructed in reliance on the separate rate treatment provided under [the program], it would be prohibitively expensive for buildings to switch to energy sources other than electricity for heating." *Commonwealth Edison*, 398 Ill.App.3d at 510, 525-26, 924 N.E.2d 1064, 1083-84. The appellate court read this as an argument for the application of promissory estoppel, but held that the doctrine did not apply because it was not reasonable for the business customers to expect that an *incentive* program would continue indefinitely. *Id.*

Consumer reliance in this case is much different than the reliance in *Commonwealth Edison*. Here, the customers paid their bills based on the rates approved by the Commission and had no reason to believe that they were paying rates that could suddenly more than double, rising to a level equivalent to the highest rates reported by the Commission and in the Carbondale rate survey. AG Ex. 1.0 at 9-10. In *Commonwealth Edison*, there was no law requiring the company to maintain the incentive rate; the rate existed at the discretion of the company. By contrast, in this docket, basic water and sewer rates are at issue, and these non-discretionary rates for

essential, monopoly services are governed by the regulatory compact between consumers and the Utilities. While it may not be reasonable, under *Commonwealth Edison*, to rely on a company to indefinitely continue a publicly acknowledged incentive program, *it is reasonable* for consumers to rely on the Utilities to perform their statutory duty to only charge rates that are just and reasonable and to change rates gradually as necessary to cover the cost of service. Here, unlike *Commonwealth Edison*, the customers' reliance on the Company to consistently seek just and reasonable rates was reasonable. The Commission violated the principles of promissory estoppels by approving rate increases of the magnitude allowed in this case. 220 ILCS 5/1-102(d).

The Order permitting the rate increases is arbitrary and capricious, contrary to law, not based on substantial evidence and lacks sufficient findings and analysis to permit informed judicial review, in violation of Section 10-201 of the Public Utilities Act. 220 ILCS 5/10-201(e)(iv). The Order in this docket should be reconsidered and the Application for Rehearing should be granted.

B. The Commission's Final Order Should Reduce the Companies' Return on Equity Due to Poor Management.

The Order rejected the AG's recommendation to reduce the Companies' return on equity to reflect poor management. The Commission based this decision on its belief that Staff witness Freetly analyzed the risk associated with investing in the common equity of the Companies, the basis upon which the cost of common equity is normally evaluated. However, the People maintain Ms. Freetly did not consider key factors unique to the Companies' requests, leaving her analysis open to further adjustment to accurately reflect the Companies' risk, management's performance, and consumers' interests.

The Commission has significant control over setting the Return on Equity ("ROE") for a regulated utility. This is an important tool that is available to the Commission to address the effect of poor management that has led the Companies to request increases in this docket that will produce rate shock. The Companies have either foregone rate increases in smaller increments, or have irresponsibly increased costs resulting in overnight increases of 251.72% (Great Northern), 45.60% (Lake Holiday), 175.82% (Camelot Water), and 71.87% (Camelot Sewer). Not only are the increases extremely high, the resulting rates would also be among the highest in the state for Great Northern and Camelot as the current rates for those utilities are already very high. AG Ex. 1.0 at 9-10. The water rate for Great Northern would be 229% and 213% higher than the state average using the Carbondale and Commission rate surveys, respectively. Camelot's water and sewer rates would be 298% and 329% higher than the Carbondale survey average and 276% and 221% higher than the Commission rate survey. *Id*.; AG Exceptions at 29. This raises the question of whether the Companies should receive the same profit level as other utilities that can operate at rates that are more in line with each other and with the value of the service they perform.

Here, the 7.71% rate of return derived by the Staff witness Freetly did not account for the water quality, management performance, or any other measure of what the services rendered by the Companies are reasonably worth. Tr. at 168, July 13, 2011. This profit level does not reflect a just and reasonable return under the circumstances of this case and should be lowered by this Commission to a rate that reflects the management problems revealed by the record in this docket. Therefore, the rate increase request should be reheard and the return on equity reduced to protect consumers from providing overly generous profits to a company that has failed to

manage its operations and to control its costs, resulting in rate increase proposals that ignore the regulatory concepts of gradualism and affordability. 220 ILCS 5/1-102(d).

C. The Commission's Final Order Should Be Amended to Reduce the Companies' Rate Base By the Amount of Unexplained Expenditures.

The Commission declined to adopt the AG's proposal to reduce the rate base of each of the Companies from the level proposed by the Companies and Staff. The Commission's conclusion was based on its belief that the evidence in the record demonstrated the need for the Companies' investments to meet their public utility service obligations. (Order at 8). However, a review of the evidence actually provided in the record demonstrates that both the identity and the need for the Companies' investments are severely lacking. The Companies offered only summary evidence – evidence insufficient to meet their burden of proof – to make a prima facie case for reasonableness of increases ranging from about 50% to more than 250%. The very size of these increases, including the Companies' proposals for recovery of investment increases made during a time when the Companies supposedly operated at a loss, requires meeting a higher standard of proof than the Companies provided in this case.

In the AG's briefs, the People showed that the Companies failed to justify *the majority* of their claimed capital expenditures, which alone increased each rate base: by $1.3 million (Great Northern), $1.3 million (Camelot), and $1.8 million(Lake Holiday). GNUI Ex. 2.0 at 5; CUI Ex. 2.0 at 5; LHUC Ex. 2.0 at 5. In response to AG data requests asking the Companies to identify their capital improvements, the Companies were only able to identify a small portion of the additional rate base claimed. Great Northern itemized $936,593 out of its claimed $1.3 million. AG Cross Ex. 1; Tr. at 25, July 13, 2011. Camelot itemized only $538,956, *less than half* of its claimed $1.3 million. AG Cross Ex. 2; CUI Ex. 2.0 at 5; Tr. at 311, July 13, 2011. The worst of all, Lake Holiday was only able to itemize $192,949, *barely 10%* of the claimed $1.8 million to

which witness Bruce Haas testified. The record does not contain any evidence that explains the difference in the expenditures itemized and the total amount claimed. As a result, it is unknown whether the unexplained expenditures were at all related to the service provided by the Companies. The Companies have therefore failed to meet their burden of proof to establish reasonableness of their proposed rates.

In its Order, the Commission acknowledged this severe gap in the evidence provided by the Companies, but said it "disagrees with the AG's assumption that every single capital improvement must be itemized to justify a rate increase." Order at 8. This is an erroneous characterization of the AG's arguments as the AG has not argued that every single capital improvement must be itemized to justify a rate increase; in fact, the AG has stated that it agrees that generally not every single capital improvement must be itemized. AG Exceptions at 4. However, these dockets are unique due to the extraordinary increases requested. The Commission and the public are entitled to know what investments have necessitated these large increases so suddenly, and whether the Companies acted imprudently in spending so much money so quickly (relative to their rate increase request). The Companies' failure to itemize the *majority* of their capital expenditures in these dockets represents an insufficient evidentiary showing in the face of the huge rate hikes being requested.

The Commission was satisfied with the Companies' statement that increases in the Companies' rate bases are due to "general ledger" additions supported by the Companies' records as reviewed by Staff. Order at 8. But some of the utilities only itemized *less than half or as little as 10%* of their capital expenditures. In such a case, general ledger additions should not be accepted as sufficient to demonstrate whether the expenditures were prudently incurred. The Commission should order rehearing to assess whether the expenditures underlying the

Companies' drastically increased rate base proposals were necessary and prudent, and whether the large number of unexplained expenditures warrants a reduction in rate base from the amount allowed in the Order.

D. The Commission's Final Order Should Deny the Allocation Factor Adjustment Because the Adjustment Lacks Sufficient Evidentiary Support.

The Commission agreed with the allocation factor adjustments proposed by Staff and accepted by the Companies, finding that the adjustments appropriately address the error in the Companies' original filing. Order at 17. The bases for both the initial allocation and the change proposed by Staff, however, were never adequately explained and therefore, it was error to increase the allocation by adopting an unexplained adjustment.

A large portion of the Companies' expenses are allocated from their affiliated Water Services Company, where economies of scale should be realized. The allocation factor adjustment, however, *increased* the costs allocated to Camelot water and sewer and to Lake Holiday, driving up expenses rather than decreasing them. Staff witness Bridal testified that the explanation provided in GNUI/CUI/LHUC Exhibit 3.0 "did not accurately reflect the process undertaken during the development of the Companies' income statement" relative to the allocation of joint company costs to the individual operating companies. Staff Ex. 11.0 at 5. In fact, Mr. Bridal recommended that the Companies be required "to provide in direct testimony in future rate cases a detailed explanation of how Utility and WSC salaries are determined in total, allocated to the individual Utility, and directly charged to rate case expense and other "cap time" categories, accordingly. The Commission should order these entities to include with this testimony all supporting schedules and evidence necessary to adequately document the explanation and the amounts set forth in the ordered testimony." (*Id.* at 6).

As the Companies' explanation of their allocation factor was inaccurate and insufficient, as evidenced by Staff's criticisms. The Companies' requests should be reheard on this issue in order to present to the Commission a clear and comprehensive explanation of the allocation method. The Commission should reverse the increase of the allocation factor because the basis for doing so was not sufficiently established. The Commission Should Consider New Evidence Showing that the Owner of Utilities, Inc. Has Recently Offered Utilities, Inc. and the Companies for Sale.

E. The Commission Should Consider New Evidence Showing that the Owner of Utilities, Inc. Has Recently Offered Utilities, Inc. and the Companies for Sale.

Since the entry of the Order, it has been reported that the owner of Utilities, Inc. ("UI"), Highstar Capital, is working with investment bankers to "explore the sale" of UI. See, e.g., http://investing.businessweek.com/research/stocks/private/snapshot.asp?privcapId=36509486 (viewed December 7, 2011). Highstar Capital acquired UI in 2005[1], and UI has been filing multiple utility rate increase requests since 2009. See ICC Dockets 09-0548 Apple Canyon (66.14% increase granted); 11-0561, Charmar (440.07% increase requested); 11-0562, Cherry Hill (127.68% increase requested); 11-0563, Clarendon (167.46% increase requested); 11-0565, Ferson Creek (90.55% increase requested); 10-0280, Galena Territories (53.64% Water, 13.34% Sewer increases granted); 11-0566, Harbor Ridge (101.92% water ,134.96% sewer increases requested); 11-0564, Killarney (245.05% increase requested); 09-0549, Lake Wildwood (55.52% increase granted); 10-0298, Northern Hills (104.84% Water, 289.76% Sewer increases granted).

The Commission should investigate the effect that a potential sale of UI may have on both the investments made in these operating companies and the rates that are being requested.

[1] http://www.highstarcapital.com/newsFull.php?id=42 (viewed December 7, 2011).

The record needs to be reopened to accept this new evidence, and the case reheard so that evidence on this potential transaction can be reviewed and evaluated.

WHEREFORE, for the foregoing reasons, the People of the State of Illinois request that the Commission order rehearing in this docket and correct the defects identified herein, or in the alternative, only allow recovery of the rates authorized in this docket subject to refund should the Order be reversed on appeal.

Respectfully Submitted,

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